STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS COMMERCE COMMISSION, On Its Own Motion, v. ILLINOIS-AMERICAN WATER COMPANY, Proposed general increase in water rates	))))))))	**ICC Doc. No. 00-0340**

BRIEF OF THE CITY OF O'FALLON,
CITY OF FAIRVIEW HEIGHTS AND VILLAGE OF CASEYVILLE
BEFORE THE HEARING EXAMINER IN RESPONSE TO
THE RATE APPLICATION OF THE ILLINOIS-AMERICAN WATER COMPANY

INTRODUCTION

The law applicable to rate proceedings is somewhat schizoid. On the one hand, rate-making is held to be a legislative function. *People ex rel. Hartigan v. Illinois Commerce Com'n,* 117 Ill.2d 120, 510 N.E.2d 865, 874 (2d Dist. 1987) ("Setting utility rates is a legislative rather than a judicial function"); *Island Lake Water Co. v. Illinois Commerce Com'n,* 65 Ill. App.3d 853, 382 N.E.2d 835, 837-38 (1978) ("It is undisputed that the fixing of utility rates is a legislative function ..."). On the other hand, the hearing procedure employed in regard to a rate application follows the model of a judicial proceeding.

The rate applicant, the Illinois-American Water Company ("the Water Co.") in the present proceeding, files its proposed rate schedule. 220 ILCS 5/9-102, 5/9-201. Thereafter, although the Commission ultimately approves or cancels the rates or other charges, it is the applicant that must first carry the burden of proving that the rates proposed are just and reasonable. 220 ILCS 5/9-201(e); *People ex rel. Hartigan v. Illinois Commerce Com'n,* 117 Ill.2d 120, 510 N.E.2d 865, 871

(1987) ("Requiring intervenors to establish unreasonableness is...no substitute for requiring proof of reasonableness"); *Central Ill. Pub. Service Co. v. Illinois Commerce Com'n*, 5 Ill. 2d 195, 125 N.E.2d 269, 277 (1955) ([W]here the Commission does decide to...hold hearings..., the burden of proof falls on the proponent of the rate..."); *Citizens Utility Bd. v. O'Connor* 121 Ill.App.3d 533, 459 N.E.2d 682, 688 (1984) ("A utility...has the burden of showing that its proposed rates are reasonable and must produce sufficient evidence to meet that burden").

Synthesizing the legislative function with its judicial process results in the following principals. No utility has the right to a rate increase merely because it has filed an application seeking one. There should not be any "mind set" that a rate application must end in a rate increase. *Central Ill. Pub. Service Co. v. Illinois Commerce Com'n*, 5 Ill. 2d 195, 125 N.E.2d 269, 275, 277 (1955) ("[T]here is no presumption in the sense that a determination of reasonableness must be reached without evidence *** The basic flaw in the appellee's theory is that it would relieve a utility of the burden of proof that its proposed rate is reasonable").

As reflected in a handout regarding rate-making issued by this Commission, there are four essential aspects to a rate case: "(1) the utility's rate base; (2) the utility's expenses; (3) the rate of return the utility is allowed to earn on its rate base; and (4) the rate design." Rate design is the allocation of the utility's cost of service among various classes of customers, which must be fair, reasonable and nondiscriminatory. 220 ILCS 5/9-101; 5/9-201(c). The rate applicant bears the burden of proof on each of these essential aspects. If it fails to carry its burden, the rate application should be denied and the rate cancelled. *Central Ill. Pub. Service Co. v. Illinois Commerce Com'n*, 5 Ill.2d 195, 125 N.E.2d 269, 273, 277 (1955) ("The Commission also found *** 'the respondent CIPS Company has failed to sustain the burden of proving the proposed Rate 12 is just and reasonable....'*** [T]he Commission is not required ... to affirmatively approve a proposed rate without a finding that it is reasonable, nor to make a finding of reasonableness in the absence of evidence"); *Citizens Utility Bd. v. Illinois Commerce Com'n*, 276 Ill.App.3d 730, 658 N.E.2d 1194, 120 (1995) ("Where the utility has presented no evidence concerning the impact of rate restructuring on ratepayers, it has not met its burden of proving the restructuring just and reasonable for those ratepayers"). In fact, the Commission will be reversed for making a determination that is not supported by substantial evidence in the record. 220 ILCS 5/10-201(e)(iv)A.

The participation of the Commission staff or intervenors does not relieve the applicant of its burden of proof as to each essential aspect. The applicant's burden of proof cannot be properly placed onto those who are responding to the rate applicant's application. *People ex rel. Hartigan v. Illinois Commerce Com'n*, 117 Ill.2d 120, 510 N.E.2d 865, 871(1987).

The evidence of the Commission staff and intervenors can be used to rebut the applicant's evidence or to support modification. The amount sought by the rate application, however, should remain the ceiling on the total amount to be collected by any rate increase. The rate applicant is a business which must be deemed to have asked for the most it needs or can legitimately anticipate receiving. The rate applicant must be left to look after its own interest. The obligation of the Commission staff, as of the Commission itself, is "to 'protect the interests of the ratepayers'" by considering the impact of the proposed rates on consumers. *Citizens Utility Bd. v. Illinois Commerce Com'n*, 276 Ill.App.3d 730, 658 N.E.2d 1194, 1200 (1995).

Unless there is substantial evidence in the record supporting the fairness, reasonableness and non-discrimination of the rate application in each of its essential aspects, the application cannot result in a rate approval. *Central Ill. Pub. Service Co. v. Illinois Commerce Com'n*, 5 Ill.2d 195, 125

N.E.2d 269, 275 (1955) ("The Commission cannot find that a rate is reasonable without evidence..."); *Citizens Utility Bd. v. Illinois Commerce Com'n*, 276 Ill.App.3d 730, 658 N.E.2d 1194, 1201 (1995) ("The Commission's finding that the restructured rates are just and reasonable is not supported by sufficient evidence because the order reports no evidence concerning the effect of restructuring. Where the utility has presented no evidence concerning the impact of rate restructuring on ratepayers, it has not met its burden of proving the restructuring just and reasonable for those ratepayers. Accordingly, we reverse the Commission's order...").

I. THE RATE OF RETURN TO THE WATER CO. SHOULD BE LIMITED TO A LOW RISK INVESTMENT LEVEL.

The City of O'Fallon's primary interest in these proceedings is rate pattern and design. Nevertheless, the City has become concerned at what appears to be an assumption that the Water Co. should be permitted to earn more than a low risk rate of return.[1] Yet, the record lacks substantial evidence that justifies a rate of return to the Water Co. much above that gained from an appropriate taxable U.S. Government debt instrument.

Even if the risks listed by President Gloriod were blindly accepted to be particular to the Water Co.[2] (I.A.W.C., Ex. 1.0, pp. 19-23,24), the "risks" are not true risks given the fact the Water

---

[1] "Risk free" return was terminology used to distinguish one element of return from another called the "risk premium" (*e.g.* Trans., 10/30/00, p. 266). In truth, no investment, and, therefore no return, is completely without risk. Purchasers of U.S. government debt instruments assume the risk of inflation over the years of its term (perhaps as many as 30). (In this regard, the investors in the Water Co. are not as exposed to risk because the Water Co. regularly comes back before this Commission every two to three years to seek adjustments to its return, and might do so more often on a showing of necessity.) Holders of U.S. government debt instruments are also exposed to other risks, such as budget appropriation stalemates. Although no investment is totally risk free, a so-called "risk free" return is similar to the fair and adequate return one would expect for taking only a modest risk like that of investing in such government instruments. In this brief, "risk free" is translated as "low risk."

[2] Only evidence relating to the Water Co. in particular is relevant. Industry generalities do not necessarily fall on each and every company within the industry and certainly not equally or with the same immediacy.

Co. is a governmentally protected and regulated entity. This Commission ensures, through its legislative rate powers, that all of the Water Co. 's expenses of service are covered and that the Water Co. is permitted to obtain a reasonable rate of return on its rate base. For instance, if there is less usage, the rate per unit will be permitted to go up to make up any shortfall. If there are fewer customers, the burden per customer will likewise be permitted to go up. Whatever happens, not resulting from the Water Co.'s own misconduct, rate relief will follow. The Water Co. is assured its recovery plus return.

Insurance, with premiums included as another rate covered expense, relieves the Water Co. of extraordinary, even catastrophic, risks, such as health incidents. The Water Co. remains a low risk investment.

It borders on fiction to identify what may be risks to ordinary business corporations as "risks" to the Water Co. within the constitutionally assured reimbursement and return on rate base environment in which the Water Co., as a regulated utility, functions. It is also illusory to speak of capital investments by the Water Co. as risks or as non- revenue producing. All but unreasonable capital investments that are made to service the Water Co. 's customers become part of the rate base on which the return to the company is calculated. Indeed, the making of investments is in large part the basis on which the Water Co. obtains its "profit" (*i.e.*, return on the rate base).[3]

There is one risk to the Water Co. that the record shows to be real — competition (*e.g.*, I.A.W.C. Ex. 1.0, pp. 22-3; I.A.W.C. , Ex. 7.0, p.16; I.A.W.C., Ex. R-1, p.9; Trans., 10/26/00, pp. 43-4,45-6,55-6, 75-7). Competition, however, should act as a limit on return, not as a reason to hike the return, and burden the ratepayers further.

---

[3] Now even maintenance produces a return on investment (*e.g.* I.A.W.C., Ex. 3.0, p. 12).

Competition is relied upon in our economy to put a downward pressure on prices. This was a principal objective in the opening up of telephone service, electricity and gas distribution to competition. Without great improvements to efficiency, which brings the unit cost down, competition will squeeze profit margins. Whatever reward draws investors to invest in companies facing competition, it is not an increase in return due to the advent of competition.

It would be counter-productive to treat competition as a risk for which investors should be rewarded with higher returns. Higher returns in the case of the Water Co.'s rate application before this Commission would have to be funded by higher rates paid by the customer ratepayers. The higher the rates paid by the customer ratepayers, the more attractive alternative sources of water become. The more attractive the alternative sources of water become, the more likely customer ratepayers will defect leaving the remaining customer ratepayers to have to pay more of the base and fixed costs that used to be shared by the defecting ratepayers (*e.g.* Trans., 10/26/00, pp. 46-7, 107, 123, 124). This in turn will drive up the rates for remaining ratepayers leading to more attrition of the Water Co.'s customer base.

The Water Co. has competition as already noted. Some large industrial water users have already begun to defect from the Water Co.'s service by accessing available ground water. Other large industrial water users, and municipal water systems, have chosen to go with a rival water system, that of the City of St. Louis. Other large water users, including the Water Co.'s purchasers for resale, such as the City of O'Fallon, are in the process of studying the prospect of leaving the Water Co. for an alternative water source. And, the Water Co. has admitted that it has already lowered its rates to some of its customers below those generally applicable to its ratepayers in order to forestall their defection to an alternative water system (*e.g.* I.A.W.C., Ex. 1.0, p.22; Trans., 10/26/00, p. 68). Furthermore, it is recognized in the testimony that if customers for resale, like the City of O'Fallon, do find it economical to take their water from an alternative system, they may then also become competitors for remaining customers of the Water Co. (Trans., 10/26/00, p. 64).

The greater the disparity between the higher rate charged by the Water Co. and the lesser cost of the other source, the greater the attraction of defecting. And, the greater the disparity the more likely it is that the amount being charged by the Water Co. is more than the value of the service supplied. No utility is permitted to charge more than the reasonable value of the service supplied. *C.f., Citizens Utility Co. of Illinois v. O'Connor*, 121 Ill.App.3d 533, 459 N.E.2d 682, 688 (1984). At a minimum, these considerations should limit the Water Co.'s return on rate base to the low end of the reasonable range.

A rate of return that is not much greater than that received on an appropriate taxable U.S. Government debt instrument is all that should be allowed. Such a return is reasonable. It would protect the ratepayers while also reducing the risk to the Company and its investors of destablizing defections and benefitting them with a more sustainable return. Were the door held open to the Water Co. to obtain a greater rate of return in this proceeding, however, the Water Co. as rate applicant has not satisfied its burden of proving what that additional rate of return should be.

The Water Co. witness who addressed this issue, Mr. Moul, testified to "water industry" generalities (I.A.W.C., Ex. 7.0, pp.12-6). He gave scant attention to the details of each company he used as the basis of his opinion, its demographics, territorial limits, customer classifications, rate structure, capital structure, infrastructure, service conditions, water sources, regulatory environment, competitive environment, historical stability, growth pattern, and other factors which may distinguish the companies he chose to use as the basis for his opinion from the Water Co.

At the same time, Mr. Moul attempts to extrapolate some theoretical risk factor from financial information (I.A.W.C., Ex. 7.0, pp. 29-30), he also admits that the details of each company must be considered when analyzing the cost of equity (I.A.W.C., Ex. 7.0, p. 30). Yet, Mr. Moul admitted that there was no company that was comparable to the Water Co. He testified:

> All of the common shares of I.A.W.C. [the Water Co.] are owned by American Water Works Company, Inc. ("AWW"). This means that the standard models of the cost of equity cannot be applied directly to the Company due to lack of stock prices.

And,

> Although the Parent Company is the source of new common stock equity for I.A.W.C., the AWW market data has not been used directly to measure the cost of equity for the Company. This position has been taken because the determination of the cost of equity for an individual company has become increasingly problematic.

(I.A.W.C., Ex. 7.0, p.3.)

His response to this lack of comparability was to average together seven water companies (I.A.W.C., Ex. 7.0, p.4). But, companies that are not individually comparable do not magically become so by being averaged together — lack of comparability in, lack of comparability out. And, utilities in other lines of business (*e.g.* natural gas distribution (I.A.W.C., Ex. 7.0, p.4) certainly do not clear the comparability hurdle. No evidence demonstrating a factor by factor sameness to the Water Co. was even attempted. *Illinois Central R.R. Co. v. Illinois Commerce Com'n,* 359 Ill. 563, 195 N.E. 32, 33 (1935) ("One of the approved methods of determining whether a proposed rate is justifiable is to compare it with rates covering the same commodities hauled practically the same distance and under similar conditions").

An opinion that is not based on comparing comparables is neither relative nor probative. *Atchison, T & S.F. Ry. Co. v. Com'n ex rel. Illinois Coal Traffic Bureau,* 335 Ill. 624, 167 N.E. 831, 838 (1929); *Alton & So.R.R.Co. v. Illinois Commerce Com'n ex rel. Perry Coal Co.,* 316 Ill. 625, 147 N.E. 417, 419 (1925) ("In these comparisons, however, they did not show that the circumstances and conditions in these other short hauls that they used for comparison were similar to the hauls from their mines to the East St. Louis switching district. These rate comparisons, not being based on evidence showing similarity of conditions, could have no probative value and was therefore incompetent.")

Only utilities and companies that are comparable to the Water Co. can provide probative evidence regarding the appropriate level of return for the Water Co. *Antioch Milling Co. v. Public Service Co. of Northern Ill.*, 4 Ill.2d 200, 123 N.E.2d 302, 308 (1954) ("Since appellants made no offer to show that the conditions of service were comparable, the evidence was properly excluded."); *Atchison, T & S.F. Ry. Co. v. Commerce Com'n ex rel. Illinois Coal Traffic Bureau,* 335 Ill. 624, 167 N.E. 831, 835 (1929) ("Comparison of existing charges made under similar conditions and of ton-mile earnings constitute proper evidence for consideration in determining what are reasonable rates.")

As Mr. Moul testified, one of the reasons that there is no comparable water company return information that can be gleaned from stock market and other financial sources is that the Water Co. is a constituent part of large amalgam of water companies, and only the umbrella parent's securities enter the public market (I.A.W.C., Ex. 7.0, p. 3). Therefore, any attempt to proceed as if there is a public market for, and public market forces operating on, the debt and investment instruments of the Water Co. itself is a fiction. (A publicly traded parent of many water companies is, as Mr. Moul admits, not comparable to a wholly-owned company that is merely a constituent of another holding company, as the Water Co. is.) Commission decisions cannot be the product of imagination and illusion. Only factual determinations arising out of competent and comparable evidence can support a rate determination. *Atchison, T & S.F. Ry. Co. v. Commerce Com'n ex rel. Illinois Coal Traffic Bureau*, 335 Ill. 624, 167 N.E. 831, 836 (1929) ("A finding without evidence is beyond the power of the commission to make, and nothing can be treated as evidence which is not introduced as such").

In a like manner, no evidence was introduced to demonstrate that utility companies in any other fields of endeavor are comparable. Indeed, the witnesses were in disagreement over how to look at companies engaged in other utility lines of business (*e.g.*, Moul excluded electric companies (I.A.W.C., Ex. 7.0, p.3, 23). Staff witness McNally looked at electric companies as part of a basket of utilities (ICC. Ex. 3.0, p.10) and Gorman rejected a basket approach (I.I.W.C., Ex. 1.0, p.14). No witness documented similarities and explained dissimilarities to the Water Co., or specifically adjusted for them.

Also, the particular regulatory environment of each respective company looked to could be very important (*e.g.* I.A.W.C., Ex. 7.0, p.30). The more closely regulated a company, the more likely it is that its rate of return is the product of its regulatory advocacy skills rather than market function. Reference to results gained from other commissions leads only to artificial circularity. Mr. Moul, and the other rate of return witnesses, testified as if there were a standard blanket rate of return due water companies, or utilities, in general. What constitutes a reasonable rate of return depends, however, upon the particular and peculiar situation of each company (as at least obliquely acknowledged by Mr. Moul (I.A.W.C., Ex. 7.0, p. 30), which is largely reflected in its own cost of capital. A closely-held self-capitalized company is not actually comparable to a publicly-held company. Mr. Moul admitted as much, and acknowledged water company holding companies do not bear meaningful witness to the proper rate of return for one of its many wholly-owned constituent holdings. The

Commission must consider only what return is reasonable to this one company before it. Its function is not simply to equalize it to others. *C.f., Illinois Central R.R. Co. v. Illinois Commerce Com'n,* 359 Ill. 563, 195 N.E. 32, 35 (1935) ("It is not the duty of the Interstate Commerce Commission to equalize profit and loss results of competing companies in different localities by overcoming geographical and commercial advantages with rate adjustments (citation omitted), and in Illinois the statute does not give the commerce commission the power to make such equalizations."). To the extent that any right to a rate of return has been shown by the Water Co., the only possibly probative evidence the rate of return on appropriate taxable U.S. government debt instruments is supported by outcome.

II. WITHOUT A COST OF SERVICE STUDY, THIS COMMISSION IS LEFT WITHOUT INFORMATION NECESSARY TO JUDGE THE FAIRNESS, REASONABLENESS AND DISCRIMINATORY EFFECT OF THE RATE PATTERN. THE RATE APPLICATION SHOULD BE DENIED AND THE RATE CANCELLED.

One essential aspect of a rate application that must be proven is that the rate pattern is fair, reasonable and nondiscriminatory. 220 ILCS 5/9-201(e). Facts are necessary and the burden of producing the evidence is on the applicant. *See,* pp. 1-4, *supra.*

A cost of service study establishes the factual basis against which the fairness, reasonableness and discriminatory effect that the rate pattern will have can be evaluated. The Water Co., however, did not file a cost of service study in support of its pending rate application. Nevertheless, the Water Co. acknowledges the evidentiary necessity of a cost of service study by attempting to piggy-back this present rate application on to the cost of service study filed with its previous rate application heard and determined some years ago. By keeping its present rate application to a proportional, "across-the-board" increase, the Water Co. adheres to its earlier cost of service study. Had the circumstances of the Water Co. remained frozen in time, this might have sufficed to meet the Water Co.'s burden. The circumstances of the Water Co., however, have not remained the same.

The Water Co. has, since its last rate application, acquired the additional territory, customers and assets of two other Illinois water companies and is in the process of acquiring yet another (which is relevant to a future, 2001 test year). (*E.g.*, I.A.W.C., Ex. 1.0, p.3; I.A.W.C., Ex. R-1, p.8; Trans., 10/30/00, p. 281-82). These changes could change the results of a cost of service study. These changes render the cost of service results of the previous study suspect and unreliable, if not actually inaccurate, in regard to the rate pattern of the present rate application. (*E.g.*, I.A.W.C., Ex. 1.0, p.3; Trans., 10/30/00, p. 281-82.) The earlier cost of service study cannot, without more evidence proving its correctness under present circumstances, satisfy the Water Co.'s burden of proof. The Water Co. did not introduce any cost of service study as evidence in this rate proceeding, nor did it introduce any evidence demonstrating the continued accuracy and applicability of the past cost of service study. The Water Co. has failed to carry its burden to introduce proof showing the fairness and reasonableness of, the absence of discrimination in, and the rate pattern of its present rate application. Consequently, the rate application should be denied and the rates cancelled.

The expert witness of the Illinois Industrial Water Consumers, Mr. Gorman, criticized the lack of a cost of service study, pointing up its importance (I.I.W.C., Ex. 1.0, p.3). Mr. Gorman's attempt to carry on in spite of the absence of a cost of service study is clearly, by his own testimony, not the way to proceed. The attempt to proceed in its absence was borne of the procedural concern of leaving the Water Co.'s rate application unaddressed and fulfills no function in the absence of a Water Co. *prima facie* showing to respond to. It cannot excuse the Water Co.'s failure to shoulder its burden of proof in support of its rate pattern, particularly when Mr. Gorman's testimony disagrees with the Water Co.'s rate pattern. The Water Co.'s rate application should, therefore, be denied and its rates cancelled. The conduct of the Commission staff also acknowledges the central evidentiary importance of a cost of service study. The Commission staff attempted to cobble together a surrogate for a cost of service study by plugging more recent cost figures into the water use framework found in the Water Co.'s earlier cost of service study (Trans. 10/26/00, pp. 112-15).

This attempt to make a cost of service study from a mixture of stale information and more recent costs is just as suspect and shares the same unreliability and possibility of inaccuracy as direct use of the Water Co.'s former cost of service study does. Indeed, the mixture of state information with more recent costs, particularly in the context of the changed circumstances of the Water Co. accentuates the possibility of misleading error (Trans., 10/26/00, pp. 114-16). And, just as the Illinois Industrial Water Consumers, the testimony of the Commission staff was borne of the procedural concern for leaving this aspect of the Water Co.'s rate application unaddressed and disagrees with the rate pattern of the Water Co. The Commission staff's effort likewise fulfills no function in the absence of a Water Co. *prima facie* showing to respond to. The Water Co.'s rate application should, therefore, be denied and its rates cancelled.

Also, this Commission itself has recognized the necessity of a cost of service study. In *Cerro Copper Products v. Illinois Commerce Com'n*, 76 Ill.App.3d 230, 395 N.E.2d 1084 (1979) *affirmed in part and reversed in part* 83 Ill.2d 364, 415 N.E.2d 345 (1980), this Commission recognized its own inability, without the results of the cost of service study, "to make any major adjustment in the existing class-revenue relationships of the various service classifications ..." *Id.* 394 N.E.2d at 1086. Although in the *Cerro* case, the Commission determined that in the absence of a cost of service study, it would be appropriate to maintain existing class-revenue relationships, this was done only on an interim basis to afford the company the time necessary to complete an already begun, detailed class cost of service study. *Id.* In the case of bar no cost of service study has been undertaken in support of the present rate application. The rate application should, therefore, be denied in its entirety, based on the Water Co.'s failure to carry its burden of proof on this essential aspect of its rate application.

If, however, this Commission decides to grant some rate increase despite the Water Co.'s failure to carry its burden of proof, then as between the Commission staff's proposal and that of the Water Co., the *Cerro* case should guide; the fairer rate pattern would be to maintain existing class-revenue relationships. This is accomplished by the Water Co.'s uniform percentage, proportionate, across-the-board rate pattern.

There are, however, glaring problems with the Water Co.'s across-the-board rate increase. One problem is the failure of the Water Co. to distinguish the rates charged its wholesale customers, like the City of O'Fallon, from those charged its larger retail water users. The Water Co. acknowledges that the City of O'Fallon is a wholesale customer and yet, in describing its territorial divisions, the City of O'Fallon is classified as a retail customer. And, the rate charged to the City of O'Fallon is no different from retail water users, even though unlike the other retail water customers, it resells the water through its own water system. (I.A.W.C., Ex. 1.0, p.9; I.A.W.C., Ex. R-1, p. 9; Trans., 10/30/00, pp. 173-76.)

The Water Co. vacillates between referring to the City of O'Fallon as a retail customer and as a wholesale customer. But, so long as the rate charged the City of O'Fallon remains a retail rate, in practical terms, it makes no difference how the City of O'Fallon is referred to. It should, however, make a difference.

The Water Co., and others, testified to the fact that costs that would otherwise be incurred in servicing retail customers are picked up by a wholesale purchaser. For instance, the cost of the distribution network is the cost of the wholesaler, not the Water Co. If the Water Co. were selling direct to the wholesaler's customers, as it does the Water Co.'s retail customers, these costs would fall on the Water Co. The responsibility for the water quality of the water supplied is shared with the wholesaler, whereas it would be entirely borne by the Water Co. if it sold direct to the wholesaler's customers. The wholesaler buys in bulk and maintains water tanks or reservoirs that might otherwise need to be constructed and maintained by the Water Co. The wholesaler provides and reads the multitude of meters that the Water Co. would otherwise have the expense of doing. (Trans., 10/30/00, pp. 173-75, 275-77.) The costs picked up by wholesalers that would otherwise be borne by the Water Co. should be reckoned in establishing a rate for a classification established for wholesalers (Trans., 10/30/00, p.277). Thus wholesalers, like the City of O'Fallon, should not be discriminated against by failing to recognize that they are already making a significant contribution to the costs of water delivery by providing their own respective systems. The City of O'Fallon, and its customers, who are indirectly customers of the Water Co. should not be required to pay a full retail rate and their pay for their own distribution system costs in addition. There is no evidentiary basis for having them do so.

There is a further defect in the rate pattern of the Water Co. The Water Co. maintains a large water user classification, but its requirements are so demanding and high that until now no customer could qualify (Trans., 10/26/00, p. 35-7). Yet there is no demonstration in the record as to why these restrictive standards, which so far have proven impractical, could not be set at a lower level. Testimony indicates that it is the large water users that are most likely to defect from the Water Co.

system. The competition factor, if nothing else, should require this category and that of wholesalers, to be set more realistically in order to reduce the potential of large Water Co. customers bolting from the Water Co.'s system.

Another problem with the Water Co.'s across-the-board uniform percentage approach is that it accentuates in real monetary terms the amount larger water users will pay. Because historically the largest use rate blocks have been increased over the last five years, the most (Block 4 up 104.01% and Block 3 up 73.39% (Trans., 10/26/00, p.50) versus Block 1 up 54.79% and Block 2 up 44.10% (Trans., 10/26/00, p. 49)) a uniform percentage increase will cost far more relatively on a base that has already been increased 104.01% than one that has been previously increased only 44.10%. For competitive reasons, if not equitable ones as well, this imposition on the two highest rate blocks should be redressed.

Furthermore, Mr. Gorman testified that the need for an increase in rate is due primarily to an increase in depreciation expense for items attributable to costs typically allocated on a customer, not volumetric, charge and a rate increase on the rate base which is, in part at least, on a customer rate basis (I.I.W.C., Ex. 1.0, p.22; Trans., 10/30/00 p.277-78). Indeed, general figures in the industry show that the bulk of Water Co. expense falls into the category shared by all customers. As Mr. Stafford testified:

> Q. ...you believe that those base costs amounted to about 65 to 70 percent of the amount that's charged to customers. Is that correct? Across all districts I think you said.
>
> A. The 65 to 70 percent I would characterize more as common costs....

> (Trans., 10/26/00, p.47.) Whether termed base costs or fixed costs, these costs are shared by every ratepayer (Trans., 10/26/00, p.48).

Because the particulars of the Water Co.'s rate pattern have not been addressed by any evidence justifying them, the Water Co. has not carried its burden of proof that its rate pattern is fair, reasonable and nondiscriminatory. Consequently, the Water Co.'s rate application should be denied and its rate cancelled for its failure to carry its burden of proof. If the Commission, however, persists in the absence of evidence on this essential aspect of the rate application to grant the Water Co. a rate increase, it should adopt other Water Co.'s rate application, but should do so only upon ordering the rate pattern to be modified to cure the defects noted herein, significantly reducing the rates paid by the City of O'Fallon, other wholesalers, and large users.

III. NO SUBSTANTIAL EVIDENCE ADDRESSES OR SUBSTANTIATES FAIRNESS, REASONABLENESS AND NONDISCRIMINATION OF SINGLE TARIFF PRICING. INDEED, THE EVIDENCE DEMONSTRATES THE UNFAIRNESS, UNREASONABLENESS AND DISCRIMINATORY NATURE OF SINGLE TARIFF PRICING IN THE INTERURBAN AND OTHER DISTRICTS OF THE WATER CO.'S TERRITORIES.

Single tariff pricing is not a cost of service concept. It is an insurance concept. It is intended to spread the risk of needed capital improvements, replacements and repairs over many ratepayers of the Water Co., reducing their impact on those particular ratepayers most directly involved and benefited. The acknowledged foundation of the theory of single tariff is that all customer ratepayers will ultimately need similar expenditures for capital improvements, replacements and repairs resulting in approximately equal reciprocity (Trans., 10/30/00, pp. 161-62). Only an approximately equal reciprocity will satisfy the legal requirements of the fairness, reasonableness and nondiscrimination.

Although the idea of reciprocity may appeal to the intuition, reality may be very different. There is no way of knowing the actual fairness, reasonableness, or discriminatory effect of single tariff pricing without actual evidence. Yet, there has been no study of reciprocity made part of the record; no evidence whatever demonstrates that an approximately equal reciprocity actually exists under single tariff pricing. And, the Commission cannot make any determination that is not supported by substantial evidence in the record. *C.f., Island Lake Water Co. v. Illinois Commerce Com'n,* 65 Ill.App.3d 853, 382 N.E.2d 835, 840 (1978) ("It is, of course, true that the commissioners are not allowed to act on their own information but must base their findings on evidence present in the case").

Single tariff pricing comes from a proposal made by the Water Co. in previous rate applications. Since the time of those rate applications, as previously noted, the Water Co. has changed with the acquisitions of other water companies and the incorporation of their territories, assets and customers. The fairness, reasonableness and discriminatory effect of single tariff pricing under this rate application, therefore, remains a factual issue which must be addressed with evidence. The Water Co. has failed to address single tariff pricing as part of its burden of proof.

Furthermore, the tendency of the evidence in the record is to contradict reciprocity. For instance, a review of almost five years of capital expenditures gives no indication of a roughly equal reciprocity between districts covered by single tariff pricing or in the interurban district alone, the second largest water service area in the entire state, in respect to the vicinity of the City of O'Fallon (*e.g.*,I.A.W.C., Ex. 2.0, pp. 13-8; Trans. 10/26/00, pp. 84-7; Trans. 10/30/00, pp. 162, 164-6). Major expenditure after major expenditure, which the City of O'Fallon and other ratepayers have had to contribute to, or will, under this rate application, have to contribute to, hold no practical benefit for them, and no proposed capital expenditures holds any practical promise of benefit to them.

The law requires a direct benefit to the customers paying the rates from the rates they are required to pay to the Water Co. *C.f.: Citizens Utility Bd. v. Illinois Commerce Com'n,* 276

Ill.App.3d 730,, 658 N.E.2d 1194, 1203 (1995) ("Current ratepayers should pay for only that plant which produces current benefits"); *Candlewick Lake Utilities Co. v. Illinois Commerce Com'n*, 122 Ill.App.3d 219, 460 N.E.2d 1190, 1196 (1983) ("The utility has the burden of proving that any operating expense for which it seeks reimbursement directly benefits the ratepayers or the services which the utility renders"). But, it is uncontradicted that the various divisions are not connected to one another. Also, the record is devoid of evidence of direct benefit to customer ratepayers like the City of O'Fallon. There is no factual basis in this record that can support the use of single tariff pricing as part of the rate pattern of the Water Co.'s pending rate application. Since one of the essential elements in the proof of the Water Co.'s rate case is missing, the rate application should be denied and the rates cancelled.

The Commission staff's rigid adherence to single tariff pricing in regard to the Alton water treatment facility brings it in conflict, not only with the Water Co.'s rate application, but also with the universally testified to philosophy underlying single tariff pricing. The Alton water treatment facility is such an enormously expensive item and of such an extraordinary and non-recurring nature, that there is no ground for believing that other ratepayers not directly benefitted by the Alton water treatment facility would ever gain back any reciprocity approximating an equality from the Alton district ratepayers (*e.g.*, Trans., 10/30/00, pp. 167-71; I.A.W.C., Ex. R-1, p.8). On a percentage basis, the Alton treatment (a continuing, progressive project) amounted to approximately 69.4% of the entire budgeted capital expenditures made since the Water Co.'s last rate application and would equal approximately 43.7% of the budgeted capital expenditures planned under the present rate application between 2000 and 2001. Single tariff pricing would not amount to a fair, reasonable and nondiscriminatory rate. It would result in an income transfer and subsidy from all other ratepayers to the benefit of the Alton district ratepayers. This cannot be justified under, nor is it consistent with, the Public Utilities Act provisions and the court decisions which limit and guide the Commission in rate cases.

To the extent that single tariff pricing is adhered to, despite the lack of any proof that it is fair, reasonable and nondiscriminatory, the Water Co.'s proposal, under its rate application, that the Alton water treatment facility be the subject to a surcharge called, an "Alton Source of Supply Charge" imposed solely on Alton district ratepayers (and thus excluded from single tariff pricing) should be approved, and any Commission staff suggestion to the contrary rejected. The Commission staff produced no evidence supporting the fairness, reasonableness and nondiscrimination of including such an enormous local one-time cost on the majority of Water Co. ratepayers (who will not obtain benefit from its existence) through single tariff pricing. Only the Water Co. has produced any evidence, and its rate application appropriately excludes the Alton water treatment facility from single tariff pricing. *C.f., Citizens Utility Bd. v. Illinois Commerce Com's,* 276 Ill.App.3d 730, 658 N.E.2d 1194, (1995) ("Current ratepayers should pay for only that plant which produces current benefits").

The evidence in the record concerning competition also demonstrates that to continue to hike up the rates of most Water Co. ratepayers to subsidize a water treatment facility that will benefit only a limited area is to run against the greater long term interest of the Water Co. and its ratepayers. While the Commission staff would drive up the rates in many districts to pay for one district's water treatment facility in a rigid adherence to single tariff pricing, the Commission staff has not been heard to argue that single tariff pricing should spread the lower rates given to meet competition.

The fact that competition from other sources of water has lured large users away from the Water Co.'s system, and continues to threaten further defections from the Water Co.'s system, has provided the reason for the Water Co. to give cheaper rates to certain larger ratepayers that were on the verge of going to a competitive source.[4] Yet, the Commission staff has not attacked such special sweetheart arrangements as violations of single tariff pricing (I.A.W.C., Ex. 1.0, p. 22, Trans. 10/26/00, pp.33-4, 68-9). Indeed, the Commission staff unrealistically overestimates the Water Co.'s insulation from competition, and adopts a posture that baits Water Co. ratepayers to go elsewhere for their water (*e.g.,* Trans., 10/26/00, p.51). The special treatment of some, while others known to be actively studying defection from the Water Co. are expected to pay still higher rates for a facility they will not benefit from must be considered, at best, an inconsistent application of single tariff pricing. Making the ratepayers already studying defection, and others pay still higher rates to subsidize Alton district ratepayers merely hastens the day ratepayers depart.

Pricing to certain particular customers at a much lower rate only because they happen to intimidate the Water Co. is a form of preference which is neither fair nor nondiscriminatory. Indeed, it is not only contrary to single tariff pricing, but it is also contrary to the intention, if not the letter, of the Public Utilities Act, 220 ILCS 5/9-241. "The Public Utilities Act does not authorize the Commission to decree preferential rates because it values one customer ratepayer more than another." *C.f., Antioch Milling Co. v. Public Serv. Co. of Northern Ill.,* 4 Ill.2d 200, 123 N.E.2d 302, 307

---

[4] The Commission can take administrative notice of its own orders (I.A.W.C., Ex. 1.0, p. 22). *Citizens Utility Bd. v. Illinois Commerce Com'n,* 276 Ill.App.3d 730, 658 N.E.2d 1194, 1199 (1995). In September 1998, the Water Co., with the approval of this Commission, gave a "Competitive Service Tariff" to the Metro-East Municipal Joint Action Water Agency formed by two customers of the Water Co., the City of Columbia, Illinois and the Commonfields of Caholsia Public Water District. The Water Co.'s submission to the Commission states: "The purpose of the Tariff is to...provide service...pursuant to rates and, as nearly as possible, other terms and conditions...[of] the city of St. Louis, Missouri..." In September, 1999, the Water Co. gave a "Competitive Service Tariff" to facilities of Solatia, Inc., Big River Zinc Corp. and Ethyl Petroleum Additives, Inc. to be known collectively as the Sarget Industrial Water Consumers.

(1954). If all ratepayers are supposed to share the costs of other ratepayers, they should also share the benefits available to other ratepayers.

CONCLUSION

Granting of a rate increase in response to the Water Co.'s rate application should not be done without more care and proof regarding the practical effects, fairness, reasonableness and discrimination of the pattern of apportionment and distribution of the rate increase among the several classes of particular ratepayers. The present pending rate application of the Water Co. should be denied and the rates cancelled. The Water Co. should be sent back to return with a much more developed rate application and with expanded evidence that can support it in conformity of applicable law.

The City of O'Fallon prays that the Hearing Examiner recommend the denial of the rate application of the Water Co. and cancellation of its rates for the reasons stated herein, or in the alternative, should the Hearing Examiner decide to recommend some rate increase to the Water Co. despite lack of evidence regarding essential elements of a rate application proceeding, that he recommend:

1. no rate of return above the low risk rate of return for the appropriate taxable U.S. Government debt instrument be permitted;

2. that a separate classification and rate for wholesalers of water be established with a lower rate than that for retail customers;

3. that, with the exception of wholesalers whose rate should be lower as a separate category, the company's proposal of an increase that is on a uniform percentage across-the-board be adopted with the adjustments among the blocks as suggested herein;

4. that the Water Co.'s proposal that the expense for the Alton water treatment plant be excluded from single tariff pricing and the subject of a special assessment paid only by those who directly benefit by the water from the Alton water treatment plant;

5. that there be a more realistic, lower threshold for water users who qualify for the large water user category;

6. single tariff pricing be jettisoned, or in the alternative, that lower rates reflecting the fact of competition be shared by all ratepayers.

Respectfully submitted,

CITY OF O'FALLON, ILLINOIS,
CITY OF FAIRVIEW HEIGHTS, ILLINOIS,
VILLAGE OF CASEYVILLE, ILLINOIS,

By: ___________________________________
DAVID LINCOLN ADER
One of Their Attorneys

DAVID LINCOLN ADER
KERI-LYN J. KRAFTHEFER
LUCY L. BEDNAREK
ANCEL, GLINK, DIAMOND, BUSH, DICIANNI & ROLEK, P.C.
140 South Dearborn Street, Suite 600
Chicago, Illinois 60603
Tel: (312) 782-7606
Firm ID No. 90053

DLA:it\C:\Tmp\17343.wpd\ 3275777.003